OCTOBER TERM 1937, DECIDED MARCH 14, 1938, 384 C. C. H. PAR. 9184; THAT THE DECISION OF THIS HONORABLE COURT IS IN ERROR IN HOLDING THAT THE AGREEMENT ENTITLING MR. O'DONNELL TO SHARE IN THE PROCEEDS OF PRODUCTION WAS MERELY A PERSONAL COVENANT ON THE PART OF THE PETROLEUM MIDWAY COMPANY, LTD.

It is the established principle of property law in the State of California that a right of one to share in the proceeds of production of oil survives the conveyance of the fee in the general estate in the land and gives to the one entitled to share in the proceeds the right to receive his percentage of the proceeds from whoever produces oil on the premises. In short, it is the established rule of property law in the State of California that one entitled to share in the proceeds of production from oil properties is enforcible in equity against the *res*. It has been recognized by this Court in the case of *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 69 L. Ed. 660, and other similar cases, that property rights and interests in minerals and the incomes derived therefrom by lessees and others, than those who own the titles, are much more valuable than the rights and interests of such owners, and it is difficult to believe that Congress intended by this grant of reasonable allowances for depletion to restrict the allowance as this Court has done in the instant case.

In the case of *Schiffman v. Richfield Oil Co. of California*, 64 Pac. (2d) 1081, decided February 25, 1937, the Supreme Court of the State of California held that the purchaser of a participating oil agreement had more than merely a personal covenant on the part of the operators of the properties to pay a sum of money measured by the net proceeds of production. It appeared that the lessees

of the oil properties had transferred to a trust the lease on specific oil properties and, in order to raise the money to drill, had sold participating agreements which gave to the trust the sole power of operating the properties but gave to the holders of the participating agreements the right to share in the net proceeds of production. The trustees after operating the properties for some time made an assignment and transfer of the leases and its rights to operate them to the Richfield Oil Company. The latter company refused to recognize the right of the holders of the participating agreements to share in the oil produced, contending that the participating agreements were merely a personal covenant on the part of the trust to pay the participants a sum of money which did not give them an interest in the *res*. In this case the Supreme Court of the State of California said at page 1086:

> "* * * The assignments in the instant case, appellant contends, are personal covenants of the Monrovia Oil Company for payment of sums of money, and are not binding upon defendant as assignee of the sublease. * * *"

At page 1087:

> "* * * These royalty assignments were not limited to oil to be produced under the existing lease, but were without limitation as to time. * * * Upon the termination of the lease, the royalty assignees would become tenants in common with each other, and with the lessor if he had retained an interest, in the profit *a prendre* to develop and produce oil. The right of profit survives the conveyance of the fee in the general estate in the land, and *gives the royalty assignee the right to receive his percentage of the proceeds from whoever produces oil on the premises.*" (Italics supplied.)

"If the effect of the percentage assignments was to create an undivided interest in the assignees in the leasehold estate, that is, in the right of profit to drill for and produce oil, notwithstanding it was understood that the lessees should retain exclusive management of the production enterprise, then as to such assignees the lessees are operating the well as their agents, or in some representative capacity. * * *"

At page 1088:

"We are of the view that whether or not the royalty assignments in this case transferred to the holders thereof an interest in the leasehold, that is, in the profit *a prendre* to produce oil, in any event they vested in the holders a right to share in the proceeds of oil produced during the continuance of the lease by an assignee of the lease with notice. * * *"

"The rights of the holders of royalty assignments to an interest in the proceeds of oil produced by an assignee of the leasehold should not depend on whether the assignment is of a percentage of the oil 'to be produced, saved, and sold,' as in Western Oil, etc., Co. v. Venago Oil Corp., *supra*, or is of a percentage of the net proceeds as in the instant case. * * *"

At page 1089:

"* * * *It is certainly not within the contemplation of the royalty holder that in addition to the other risks involved, the lessee may at any time terminate the royalty holder's interest by assigning the lease, and leave the royalty holder either remediless or with a claim for a share of the price received by the lessee for the transfer of the leasehold, or a claim for monetary damages.*" (Italics supplied.)

"* * * In contracts relating to land, the equitable conversion of title to the buyer and the remedy of specific performance may be asserted against a purchaser of the land with notice. Where royalty assignments are made by a lessee, the holders thereof have an interest in oil produced by an assignee of the leasehold covering the land from which the oil is to be produced who acquires the leasehold with notice, or in the proceeds thereof. * * *"

The foregoing decision of the Supreme Court of the State of California establishes a property right and therefore it is respectfully submitted that this Court is bound by the views of that court. (*Freuler v. Helvering,* 291 U. S. 35, 54 Sup. Ct. 308, 13 A. F. T. R. 834, and *Sharp, Executors, v. Commissioner of Internal Revenue,* Supreme Court of the United States, October Term 1937, decided March 14, 1938, 384 C. C. H. Par. 9184).

If Mr. O'Donnell merely acquired under the terms of the contract with Petroleum Midway Company, Ltd. a personal covenant on the part of the Petroleum Midway Company, Ltd., the bankruptcy of that company would defeat the rights of Mr. O'Donnell. This is just exactly what the Supreme Court of the State of California has prohibited.

This Honorable Court in its opinion states:

"* * * The ownership of the oil and gas properties was in the corporation. When the Midway Company acquired these properties from the San Gabriel Company and operated them, the Midway Company became the owner of the oil and gas produced. * * *"

These statements are in direct conflict with the established property laws of the State of California. This Court further stated:

> "* * * No trust was declared by which respondent could claim an equitable interest in the *res.* * * *"

This statement likewise is directly in conflict with the decisions of the Supreme Court of the State of California and is therefore contrary to the principles of law established by this Court in such cases as *Freuler v. Helvering,* 291 U. S. 35, 54 Sup. Ct. 308, 13 A. F. T. R. 834, and *Sharp, Executors, v. Commissioner of Internal Revenue,* Supreme Court of the United States, October Term 1937, decided March 14, 1938, 384 C. C. H. Par. 9184.

Under the contract the Midway Company not only agreed to share the proceeds of production with Mr. O'Donnell but it agreed

> "to comply with all the terms and conditions of the various leases, contracts and agreements now owned by said San Gabriel Petroleum Company, and to do and perform each and all such acts and things as may be necessary to protect said leases, contracts and agreements from cancellation or forfeiture." [R. 79.]

This provision indicates that Mr. O'Donnell was protecting his interest in the *res* not merely to get an economic advantage but to protect his interest in the leaseholds themselves. In this contention it should not be forgotten that Mr. O'Donnell with others, was the original lessee who had transferred the leases to the San Gabriel Petroleum Company. This fact makes the case even stronger than the case of *Schiffman v. Richfield Oil Co. of California,* 64 Pac. (2d) 1081, because it shows definitely that

if the Petroleum Midway Company should permit a forfeiture of the lease that Mr. O'Donnell would thereby become responsible to the lessors and would have a right to do the operating himself.

While it is true that if there were no net profits Mr. O'Donnell would not receive anything, but under these circumstances neither would the Petroleum Midway Company. In short, the economic interests of both depended upon the economic production—the realization of net profits. Unless there were net profits, naturally no one would be entitled to depletion because the statute limits depletion to 50 per cent of the net and 50 per cent of nothing, of course, equals nothing. Petroleum Midway Company, Ltd. certainly did not own the 100 per cent economic interest of the oil properties. When it paid Mr. O'Donnell his share of the proceeds it was merely buying an economic interest in the proceeds of production. Petroleum Midway Company, Ltd. under no stretch of the imagination is entitled to depletion on the amount paid to Mr. O'Donnell. Its gross income naturally would be the amount received less amounts paid to a land owner and to Mr. O'Donnell. Mr. O'Donnell's investment in the proceeds of production was as much of a capital investment as was the investment of the Midway Company. Capital does not merely consist of money, it may consist of stock. That is what Mr. O'Donnell transferred for his interest in the oil properties. This stock was no less capital than cash would have been.

The decision of this Honorable Court in the instant case is of very great importance to taxpayers throughout the land. It is unlike other cases with which it was wrongfully grouped. Merely because a processor of gas does not have an interest in the *res* is no reason for holding

that under the circumstances in this case Mr. O'Donnell likewise does not. The opinion of this Court, as heretofore indicated, is in direct conflict with the property laws established by the Supreme Court of the State of California. It is also, we respectfully submit, contrary to the many decisions of this Honorable Court in such cases as the cases of *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 69 L. Ed. 660; *Palmer v. Bender*, 287 U. S. 551, 77 L. Ed. 489, and similar cases and the other cases herein cited.

We sincerely urge that the decision of this Honorable Court works a grave injustice upon this taxpayer and will unjustly affect many taxpayers similarly situated. It is of vital importance and therefore we sincerely urge that this petition be granted and that Mr. O'Donnell be given an opportunity of orally presenting this matter before this Honorable Court.

Respectfully submitted,

THOMAS R. DEMPSEY,
A. CALDER MACKAY,
1104 Pacific Mutual Building,
Los Angeles, California,
Attorneys for Thomas A. O'Donnell.

Certificate of Counsel.

I, A. Calder Mackay, counsel for Thomas A. O'Donnell, do hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay.

A. CALDER MACKAY,
Counsel for Thomas A. O'Donnell.

IN THE

SUPREME COURT

OF THE

UNITED STATES.

October Term, 1937.

No. 406.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

vs.

THOMAS A. O'DONNELL,

Respondent.

Motion to Stay Issuance of Mandate.

Now comes Thomas A. O'Donnell, by his attorneys, Thomas R. Dempsey and A. Calder Mackay, and shows to this Court:

Within the time allowed by the rules of this Court said Thomas A. O'Donnell is filing his petition for a rehearing of this cause and a modification of the judgment of this Court entered herein on March 7, 1938, for the reasons set forth in said petition.

Under Rule 31 of this Court such petition will not operate to stay the mandate of this Court, and such mandate will issue as of course after the expiration of twenty-five (25) days from the day said judgment was entered, unless otherwise ordered.

In view of the nature of said petition for rehearing and the end sought to be accomplished thereby, no useful pur-

pose would be subserved by the issuance of the mandate of this Court prior to the disposition of said petition; but, on the contrary, unnecessary complications would result.

Wherefore, said Thomas A. O'Donnell prays that the mandate of this Court be stayed and withheld until said petition for a rehearing shall have been acted upon and disposed of by this Court.

THOMAS R. DEMPSEY,
A. CALDER MACKAY,
1104 Pacific Mutual Building,
Los Angeles, California,
Attorneys for Thomas A. O'Donnell.

SUPREME COURT OF THE UNITED STATES.

No. 406.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Thomas A. O'Donnell.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[March 7, 1938.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

Respondent, Thomas A. O'Donnell, owned one-third of the capital stock of the San Gabriel Petroleum Company. By contract of January 9, 1918, he sold this stock to the Petroleum Midway Company, Ltd. As consideration, the Midway Company agreed to pay to respondent one-third of the net profits from the development and operation of the oil and gas properties then owned by the San Gabriel Company and which the Midway Company agreed to acquire. That acquisition was made, the properties thus acquired were developed and operated, and one-third of the net profits thus derived were paid to respondent to August 4, 1926. With respect to such payments in the years 1925 and 1926, respondent claimed deduction for depletion, which the Board of Tax Appeals allowed, overruling the Commissioner of Internal Revenue. 32 B. T. A. 1277. The Circuit Court of Appeals affirmed the decision of the Board. 90 F. (2d) 907. We granted certiorari. — U. S. —. See *Helvering* v. *Bankline Oil Company,* decided this day.

The question is whether respondent had an interest, that is, a capital investment, in the oil and gas in place. Revenue Act of 1926, sec. 204 (c) (2); sec. 214 (a) (9). *Palmer* v. *Bender,* 287 U. S. 551, 557; *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312, 321; *Thomas* v. *Perkins,* 301 U. S. 655, 661; *Helvering* v. *Bankline Oil Company, supra.* As a mere owner of shares in the San Gabriel Company, respondent had no such interest. Treasury Regulations No. 69, Art. 201. The ownership of the oil and gas properties was in the corporation. When the Midway Company acquired these properties from the San Gabriel Company and operated them, the

Midway Company became the owner of the oil and gas produced. It was the owner of the gross proceeds or income upon which the statutory allowance for depletion was to be computed. *Helvering* v. *Twin Bell Syndicate, supra.* The agreement to pay respondent one-third of the net profits derived from the development and operation of the properties was a personal covenant and did not purport to grant respondent an interest in the properties themselves. If there were no net profits, nothing would be payable to him. No trust was declared by which respondent could claim an equitable interest in the *res.* As consideration for the sale of his stock in the San Gabriel Company respondent bargained for and obtained an economic advantage from the Midway Company's operations but that advantage or profit did not constitute a depletable interest in the oil and gas in place. *Palmer* v. *Bender, supra; Helvering* v. *Bankline Oil Company, supra.*

The judgment of the Circuit Court of Appeals is reversed and the cause is remanded for further proceedings in conformity with this opinion.

It is so ordered.

Mr. Justice CARDOZO and Mr. Justice REED took no part in the consideration and decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.